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CCP PART III SECTION 6

CREDIT PRACTICE

THURSDAY: 28 November 2019. **Time Allowed: 3 hours.**

Answer ALL questions. Marks allocated to each question are shown at the end of the question.

QUESTION ONE

HABARI MEDIA GROUP (HMG)

Habari Media Group (HMG) is a Kenyan media group that is listed on the Nairobi Securities Exchange. HMG was founded in 1969 and is the largest media house in East and Central Africa. The company has invested in media and entertainment with businesses in television and print media.

Despite its enormous success in the media business, HMG has been experiencing an increase in outstanding debtors. Prior analysis have revealed that the company's debt level has been increasing with the company's growth in terms of turnover. Between years 2016 and 2018, total turnover increased by Sh.1.126 billion while credit sales increased by Sh.901.5 million, leading to the increase in debt level from Sh.351.2 million in year 2016 to Sh. 603 million in year 2018. The company's debt position has been worsening over the years in terms of value and number of days' sales in receivables.

The Board of Directors of the company is concerned about the debt's position and believes that if the trend is not reversed, the company will soon or later find itself in cash flow difficulties. As a result, they have approached you as a credit specialist to advice on why there is an increasing level of outstanding debtors in HMG. As part of your assignment you have conducted a research on the company's credit operations and discovered the following:

1. The credit control department is headed by a revenue accountant who is in charge of all revenue activities of the company.

2. Despite enormous growth in sales over the last few years, the company's credit policy has remained the same without review.

3. HMG's credit control staff and sales staff have never had any training on credit management.

4. The company's major customers are newspaper distributors and advertising agencies.

5. A significant percentage of credit customers do not provide the necessary financial documents for credit assessment purposes.

6. Advertising agencies are the main debtors of HMG, currently the amount due from them is 60% of the total outstanding debt. HMG directors are reluctant to request the agencies to provide additional security because they fear by doing so they could lose them to competition.

7. Some clients notably the distributors have problems in understanding the company's financial documents. For instance some have difficulty in differentiating invoices from credit notes.

8. Appointment of distributors and advertisers is not done by way of clear evaluation and interview procedures but instead they are freely appointed.

9. The current commission structure is not motivating enough to ensure early collection of the receivables by the sales staff.

10. HMG is a member of a Credit Reference Bureau. However, it does not make use of the available services.

11. HMG, operations are mainly manual and as such financial documents like invoices, credit notes and statements are not promptly processed by HMG to facilitate payment as quickly as possible. Thus, 80% of the distributors and advertisers do not receive the necessary financial documents on time.

Required:

(a) Describe five practices in credit management of HMG that could be a source of credit risk. (10 marks)

(b) Describe four types of services that the management of HMG could seek from Credit Reference Bureaus (CRB). (8 marks)

(c) Analyse five benefits that would accrue to HMG as a result of automating accounts receivable management. (10 marks)

(d) Propose six measures that the management of HMG could put in place to reduce their debt level. (12 marks)

(Total: 40 marks)

QUESTION TWO

(a) (i) Explain the meaning of the term "credit enhancement" as used in credit management. (2 marks)

(ii) Evaluate four types of credit enhancement. (8 marks)

(b) Highlight five internal factors that could lead a company into financial distress. (5 marks)

(Total: 15 marks)

QUESTION THREE

(a) Examine four effects of delinquency on credit portfolio. (8 marks)

(b) Describe seven strategies employed by a firm in managing delinquent loans. (7 marks)

(Total: 15 marks)

QUESTION FOUR

(a) Discuss four limitations of using financial statements to assess the creditworthiness of a customer. (8 marks)

(b) Enumerate four qualities of a good collateral. (4 marks)

(c) Explain three determinants of the level of working capital in a company. (3 marks)

(Total: 15 marks)

QUESTION FIVE

(a) Propose four warning signs of bad and doubtful debts. (8 marks)

(b) (i) Explain the term "syndicated loan". (2 marks)

(ii) Enumerate five features of a syndicated loan. (5 marks)

(Total: 15 marks)

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